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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Deployment of Wireline Services Offering Advanced Telecommunications Services	)	CC Docket No. 98-147
	)	
	)	

COMMENTS OF THE ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES

Richard J. Metzger
Emily M. Williams
Association for Local Telecommunications Services
888 17th Street, N.W., Suite 900
Washington, D.C. 20006
(202) 969-2583

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SUMMARY

Although the current proceeding overflows with the acronyms and technological descriptions that seem to accompany every discussion of advanced wireline services, the significance of the Advanced Wireline Services Order needs to be kept in sight. At bottom, this proceeding fundamentally renews the Commission's traditional commitment to competition by declaring that advances in wireline telecommunications -- advances that are critical to providing all Americans with access to the Information Age -- will be deployed by a robust competitive market.

But turning that competitive future into a near-term reality involves hard work, and careful analysis concerning how incumbent providers can use their control over the network to limit competition in this specific market. In order to accelerate that analysis, ALTS is submitting a paper, "Economics and Technology of Broadband Deployment" by HAI Consulting, Inc., that formulates an appropriate framework for addressing these issues, the "Broadband Local Exchange Network" ("BLEN"). Basic findings in that paper and these comments include:

- Creation of unregulated in-region affiliates will harm competition unless the Commission identifies all the features, services and facilities that are essential to non-affiliated competitors, and requires that they remain with the incumbent.

- The history of separate subsidiaries in other situations fully demonstrates that such regimes cannot work unless rules are fully accompanied by vigorous enforcement.

- In determining which features, services and facilities of the incumbent are essential to non-affiliated competitors, the Commission should not simply assume that loops are the sole source of incumbent market power. Instead, the Commission should recognize from the BLEN analysis that the "loop, collocation space, and OSS" trio emphasized in the Advanced Wireline Services Order is unduly limited even in the case of xDSL (as when DSL is deployed over digital loop carrier systems), and quite inapplicable to likely future developments in wireline advanced services.

- State rules and voluntary arrangements relating to competition for advanced wireline services already exist in some places. The Commission needs to "jumpstart" broadband competition by turning these existing practices into national rules until more formal interface specifications are completed.

While this pleading contains much technical information, ALTS' goal is not to ask the Commission to choose particular technological alternatives. Rather, ALTS seeks to inform the Commission of the subtleties involved in furthering broadband, with the hope that this increased awareness will assist the Commission in issuing basic rules and principles that will accelerate competition in advanced wireline services.

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The Association for Local Telecommunications Services ("ALTS") hereby comments on the Notice of Proposed Rulemaking released August 7, 1998, in Deployment of Wireline Services Offering Advanced Telecommunications Capability, FCC 98-188 ("Advanced Wireline Services Order").[1] These comments are accompanied by a paper, "Economics and Technology of Broadband Deployment," prepared by HAI Consulting, Inc. ("HAI Broadband Paper"). Part I of these comments addresses the legal and economic aspects of the Advanced Wireline Services Order's proposal to create rules for in-region ILEC affiliates providing advanced telecommunications services. Part II sets out the minimum requirements that should be imposed on such affiliates as a policy matter. Part III addresses issues principally involving requests by ALTS and its members for actions that will advance competition in advanced telecommunications services. Part IV concerns the Advanced Wireline Services Order's request for comments on a targeted reduction or elimination of section 271

[1] ALTS is a national trade association representing facilities-based competitive providers of local telecommunications services.

requirements in particular circumstances.

I. IN-REGION ILEC AFFILIATES AND THE REQUIREMENTS OF SECTION 251(c).

The Commission in its Advanced Wireline Services Order steadfastly upheld the applicability of section 251(c) to any advanced wireline services deployed by the incumbent local exchange carriers ("ILECs"): "We conclude that Congress did not provide us with the statutory authority to forbear from these critical market-opening provisions of the Act [sections 251(c) and 272] until their requirements have been fully implemented" (at ¶ 12).

However, the Commission went on to raise the possibility of creating in-region ILEC affiliates that might not be subject to section 251(c) in order to stimulate innovation by the ILECs (id. at 13):

> "We are committed, however, to ensuring that incumbent LECs make their decisions to invest in and deploy advanced telecommunications services based on the market and their business plans, rather than regulation. Accordingly, in the NPRM, we propose an optional alternative pathway for incumbent LECs that would allow separate affiliates to provide advanced services free from incumbent LEC regulation. In particular, if an incumbent chooses to offer advanced services through an affiliate that is truly separate from the incumbent, that affiliate would not be deemed an incumbent LEC and therefor would not be subject to incumbent LEC regulation, including the obligations under section 251(c)".

While ALTS shares the Commission's desire to insure that regulation does not slow the deployment of advanced wireline

services, there are two important considerations the Commission should weigh in pursuing this goal. First, there are legal limits imposed by the Act on the Commission's options. It will not assist any policy goal if the Commission were to adopt a separate subsidiary approach that cannot be sustained upon appeal. ALTS discusses these legal limits below (Part I.A.). Second, the Commission's approach rests on the assumption that -- all other things being equal -- ILECs have an economic incentive to deploy advanced telecommunications services, an incentive that might be impaired by regulation. The truth is that the most powerful incentive the ILECs have to make these investments is the possible entrance of CLECs or other technologies. Consequently, the touchstone of any Commission efforts to accelerate broadband deployment should be on assuring effective facilities-based competition (see Part III infra; HAI Broadband Paper at 26-29).

A. The Legal Limitations on Creation of ILEC Separate Subsidiaries for Advanced Telecommunications Services.

The Advanced Wireline Services Order assumes that in-region affiliates meeting appropriate structural safeguards need not be treated as incumbents simply because they happen to provide exchange services (at ¶ 89):

> "The obligations set out in section 251(c) of the Act are imposed only on incumbent LECs. In the Non-Accounting Safeguards Order, the Commission concluded that a BOC affiliate that satisfies appropriate structural separation requirements is not deemed an incumbent LEC for purposes of section 251 merely because it is engaged in local exchange activities .... in order to be deemed an incumbent LEC, a

carrier must meet the definition in section 251(h)."

Later on, the Advanced Wireline Services Order reiterates this same point (at ¶ 91): "In the Non-Accounting Safeguards Order, the Commission determined that a BOC affiliate is not 'comparable' to an incumbent LEC under section 251(h)(2) merely because it is engaged in local exchange activities." Based on this analysis, the Advanced Wireline Services Order then jumps to the conclusion that an in-region affiliate that provides exchange services and complies with the requirements of section 272 is not subject to section 251(c) (at ¶ 92). For the reasons discussed below, the Advanced Wireline Services Order's legal interpretation of section 251(h), and its reliance upon the Non-Accounting Safeguard Order, are entirely unfounded.

1. Section 251(h) Does Not Authorize the Commission to Create ILEC Corporate Subsidiaries that Are Immune from the Requirements of Section 251(c).

Ameritech asked the Commission in its section 706 petition to "clarify" section 251(h) so as to provide that section 251(c) applies only to ILECs proper, and not to any data affiliates of the RBOCs which comply with section 272 (Ameritech Petition at 25). Without citing to Ameritech's arguments, the Advanced Wireline Services Order asserts that: "In the Non-Accounting Safeguards Order, the Commission determined that a BOC affiliate is not 'comparable' to an incumbent LEC under section 251(h)(2) merely because it is engaged in local exchange activities" (at ¶ 91; the Advanced Wireline Services Order's reliance on the Non-

Accounting Safeguards Order is discussed supra at Part I.A.2).

The Commission has already addressed section 251(h) elsewhere, and determined that it provides the definition of incumbent LEC, and also "sets forth a process by which the FCC may decide to treat LECs as incumbent LECs" (Local Competition Order at ¶ 1248). Thus, the Commission has concluded that section 251(h) dictates when the statute imposes incumbent LEC regulation on LECs that do not currently bear that burden; it is not a device by which to relieve incumbent LECs of their regulatory duties through the guise of a corporate affiliate. Clearly, the Advanced Wireline Services Order would turn this ruling on its head by making section 251(h) into a source of forbearance authority.

The fallacy of the Advanced Wireline Services Order's proposed interpretation of section 251(h) is easily demonstrated. By moving new investment into a separate subsidiary simply by sticking the label of "data services" on whatever it chooses, Ameritech could exploit such a "clarification" to effectively gut section 251(c)'s requirements.[2]

Assume that ILECs operated in an environment where technological progress did not exist, but in which

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[2] Indeed, given Ameritech's claims that no meaningful distinction can be made between data and voice, Ameritech is effectively claiming the freedom to place all new technology, as well as replacements of existing technology, in an affiliate.

telecommunications facilities continued to depreciate and require eventual replacement. Any incumbent that tried to place replacement facilities in a separate subsidiary, and then claim the subsidiary was somehow immune from section 251(c)(3) and 271 obligations would plainly be guilty of avoiding the statute in precisely the same fashion if it had simply transferred the assets to the separate subsidiary. The situation is no different in our real world when the replacement of an asset is dictated by technological innovation in addition to physical deterioration. To put the point simply, the Bell System could not have escaped interstate rate regulation of its long distance services simply by placing microwave facilities in a separate subsidiary when that technology took hold after World War II.[3]

In particular, the DSL services trumpeted by the incumbents are nothing more than a series of on-going incremental improvements in the bandwidth of the local loop, and less of an improvement, proportionally, over ISDN, than ISDN was over plain copper. Clearly, a "transfer" of assets occurs under section 251(h) whenever an incumbent places such assets in a separate subsidiary regardless of how the assets are acquired. For

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[3] Consider another example demonstrating the lack of any meaningful distinction between the transfer of an asset to an affiliate, and the affiliate's direct acquisition of that asset. Suppose an incumbent sold assets to a third party, which then turned around to sold the same assets to the affiliate. This would technically be an "acquisition," but economically it would be identical to a direct transfer.

example, Ameritech refused last year even to negotiate frame relay interconnection arrangements with one major CLEC. Ameritech claimed that frame relay services are not "exchange services" as defined by the 1996 Act and, thus not subject to the requirements of Section 251. But after the CLEC sought arbitration of the issue in three states,[4] and an Illinois Commerce Commission ALJ issued a proposed decision rejecting Ameritech's position,[5] Ameritech finally agreed to interconnect its frame relay network with the CLEC's.

2. The Non-Accounting Safeguards Order Provides No Legal Authority for the Creation of Separate In-Region Advanced Data Services Affiliates.

With all due respect, there is an obvious and fundamental fallacy in the Advanced Wireline Services Order's reasoning concerning section 272. The Non-Accounting Safeguards Order interpreted the requirements of section 272 against the background of: (1) the circumstances that would exist when an RBOC has complied with section 271 (aside from certain incidental

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[4] Illinois Commerce Commission, Petition by Intermedia Communications Inc. for Arbitration with Ameritech-Illinois Pursuant to the Telecommunications Act of 1996, Ill. CC Docket No. 87-AB-002 [hereinafter "Ill. CC Intermedia/Ameritech Arbitration"]; Indiana Utility Regulatory Commission, Petition by Intermedia Communications Inc., for Arbitration with Ameritech-Indiana Pursuant to the Telecommunications Act of 1996, In. URC Cause No. 40787-INT-01; Ohio Public Utilities Commission, Petition by Intermedia Communications Inc. for Arbitration with Ameritech-Ohio Pursuant to the Telecommunications Act of 1996, Oh. PUC Case No. 97-285-TP-ARB.

[5] Ill. CC Intermedia/Ameritech Arbitration, Hearing Examiner's Proposed Arbitration Decision, at 5-6.

interLATA relief effective immediately under 271(g)); and (2) whether any residual market strength in local exchange services (following compliance with section 271) could still be used to harm competition in the mature long-distance industry.[6]

The Commission's interpretation was based on the fact that Congress drafted section 272 with the clear understanding that the robust pro-competitive requirements of section 271 would already be in place before section 272 ever became applicable (again, aside from the certain incidental interLATA services the RBOCs are authorized to implement immediately by section 271(g)).[7]

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[6] See, e.g., Non-Accounting Safeguards Order at ¶ 6: "These safeguards are intended both to protect subscribers to BOC monopoly services, such as local telephony, against the potential risk of having to pay costs incurred by the BOCs to enter competitive markets, such as interLATA services and equipment manufacturing ...;' ¶ 10: " ... BOC entry into in-region interLATA services raises issues for competition and consumers, even after a BOC has satisfied the requirements of section 271(d)(3);" ¶ 12: " ... if a BOC charges other firms prices for inputs that are higher than the prices charged, or effectively charged, to the BOC's section 272 affiliate, then the BOC could create a 'price squeeze'"; and ¶ 258 (declining to adopt additional rules to address "price squeezes" because "the danger of successful predation by BOCs in the interexchange market is small;" emphasis supplied).

[7] See, e.g., SBC Communications v. FCC, 5th Cir. No. 98-10140 (slip opinion issued September 5, 1998, at 8):

> "Essentially, the Special Provisions recreate most of the original line-of-business prohibitions of the MFJ, with some tweaking. In the case of information services, the recreation represents a reimposition of restrictions that had already been lifted under the regime of the MFJ. In the case of in-region long distance service and telecommunications equipment,

(continued...)

Thus, section 272 necessarily reflects Congress' conclusions about the manner in which an RBOC that has already substantially complied with section 251 should enter the mature, highly competitive long distance industry. Section 272 provides little if any policy guidance concerning the appropriate conditions that should apply to the very different scenario posed by the separate subsidiary proposal, under which incumbents that have not complied with section 251 could create in-region data affiliates that would be allowed to provision high-speed local loop services without also complying with section 251(c).[8]

Furthermore, the inadequacy of section 272 as a starting point in constructing a policy framework for forbearing to regulate in-region data affiliates is amplified by the fact that the understanding of the Commission and the industry concerning

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[7](...continued)
however, the Act simply changes the administrator and specifies the rules by which Judge Greene's long-running restrictions can be lifted."

[8] Indeed, the Commission has already ruled as a legal matter that nothing in section 272 confers such forbearance authority upon the Commission. BellSouth Petition for Forbearance from Application of Section 271 of the Communications Act of 1934, CC Docket No. 96-149, Order released February 6, 1998, at ¶¶ 22-23 ("... prior to their full implementation we lack authority to forbear [under section 10] from application of the requirements of section 272 to any service for which the BOC must obtain authorization under section 271(d)(3)"). Inasmuch as section 10 expressly applies to section 251(c) as well as to section 271, the BellSouth Order demonstrates there is no sound legal authority permitting the Commission to forbear from applying section 251(c) to an in-region data affiliate simply because it complies with section 272.

the specific requirements of section 272 and the Non-Accounting Safeguards Order is uncertain at best. As the United States Court of Appeals for the District of Columbia remarked in rejecting an appeal from the Commission's first implementation of this provision: "This case arises from a challenge to an Order of the Federal Communications Commission ... construing a poorly drafted section of the Telecommunications Act of 1996, enacted as 47 U.S.C. § 272" (Bell Atlantic v. FCC, 131 F.3d 1044 (1997); emphasis supplied).[9]

Because the Advanced Wireline Services Order assumes the Non-Accounting Safeguards Order applies without ever examining that assumption, it is helpful to consider the claims of the RBOC that originally raised this claim, Ameritech. In its section 706 petition, Ameritech argued that the Commission has the authority not to apply section 251(c) to an in-region affiliate of an RBOC that complies with section 272 (Ameritech Petition filed March 5, 1998, at 24):

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[9] The confusion over the exact requirements of the Non-Accounting Safeguards Order outside its appropriate sphere has recently been underscored by the recent efforts of U S WEST and Ameritech to joint market long distance services in reliance on that order. U S WEST's efforts have been enjoined by the United States District Court for the Western District of Washington, and the Commission recently issued a standstill order against Ameritech's efforts in a complaint action brought by long distance carriers and members of ALTS. AT&T Corp. v. Ameritech and Qwest, File No. E-98-41, Memorandum Opinion and Order, released June 30, 1998.

> "... as held in the Non-Accounting Safeguards Order, under section 251(h), a BOC affiliate is not an incumbent LEC for section 251 purposes unless it 'occupies a position in the market for telephone exchange service with an area that is comparable to the position occupied by the incumbent LEC, and such carrier has substantially replaced an incumbent LEC' .... For the same reasons that a BOC affiliate that provides local exchange services is not an incumbent LEC, a BOC affiliate that owns its own broadband data facilities (or leases such facilities from an unaffiliated entity) is not an incumbent LEC .... Ameritech asks the Commission to clarify that its construction of section 251(h) applies not only to section 272 affiliates, but to any broadband data affiliate that meets the modified separation requirements proposed herein."

Ameritech subsequently modified its position by refusing to accept even the requirements of section 272 as an adequate basis for a separate subsidiary (see the prepared statement of Mr. Ali Shadman presented at the July 9th en banc held by the Commission concerning advanced data services at 3-4):

> "Ameritech plans on offering its advanced telecommunications capabilities through a lightly regulated subsidiary. Ameritech's subsidiary will act like any other CLEC and will use the same operational support systems ordering, establishing trouble tickers, billing etc. that are available to all CLECs. It would maintain separate books, not own joint transmission or switching equipment and obtain all telecommunications service, network elements and collocations from tariff. Ameritech does not believe all of the requirements of Section 272 should apply. In particular the restriction on use of incumbent employees for installation and maintenance services, and the restriction on sharing of administrative services will slow the introduction of these services."

Thus, it is plain that the Non-Accounting Safeguards Order does not authorize creation of advanced wireline separate

subsidiaries for RBOCs that have not complied with section 271, nor is there any basis for concluding that any RBOC would willingly accept the conditions of the Non-Accounting Safeguards Order as the basis for creating such an entity.

B. ILECs Currently Lack Appreciable Economic Incentives to Deploy Advanced Telecommunications Services in the Absence of Competitive Pressures.

The Commission's approach in the Advanced Wireline Services Order rests on the assumption that -- all other things being equal -- ILECs have an economic incentive to deploy advanced telecommunications services, an incentive that might be impaired by inappropriate regulation. The truth is that the best incentives the ILECs have to make these investments is the imminent entrance of CLECs or other technologies. If this incentive is to be maximized, appropriate regulation designed to curb ILEC abuses is essential. Consequently, any reduction in regulation by the Commission will likely reduce and not increase the speed of incumbent deployment of advanced wireline technologies unless the Commission also takes vigorous action to assure the success of facilities-based broadband competition (HAI Broadband Paper at 20-23).

Thus, it is quite unlikely incumbents will be motivated to roll out data services faster if pro-competitive protections for advanced telecommunications services are stripped by means of an in-region affiliate scheme (id. at 37-48). Indeed, several incumbents have already signaled their reluctance to utilize a

properly constructed in-region affiliate option. For example, at the Commission's July 9, 1998, en banc meeting held to discuss advanced telecommunications services, U S WEST's representative, Mr. Joe Zell, condemned the use of a separate data affiliate, stating that it would only drive up his company's costs of providing service. U S WEST's comments are also consistent with the incumbents' recent statements in Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services, CC Docket No. 95-20 ("Computer III FNPRM").

The incumbents in Computer III FNPRM denounced any imposition of separate subsidiary requirements stating that it would be: "denying the public the benefits of innovation:"

> "The Commission has concluded on multiple occasions that separate affiliate requirements impose material costs on carriers in the form of higher transaction and production costs. These costs are naturally passed on to the public in the form of higher prices. Similarly, the Commission has previously concluded that the introduction of new information services by the BOCs has been slowed or prevented altogether by structural separations, thus denying the public the benefits of innovation."[10] (Comments of BellSouth filed March 27, 1998, in Computer III FNPRM, at 16; emphasis supplied.)

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[10] See also Bell Atlantic Comments at 8: "... a return to structural separation would cause serious public harm. By imposing enormous costs on the Bell companies, it would lead to higher prices for their existing information services and deter investment in innovative new services." U S WEST Comments at 11: "Giving BOCs the flexibility to provide enhanced services on an integrated basis also produces significant public interest benefits by encouraging the introduction of new services."

See also SBC's Comments in Computer III FNPRM filed March 27, 1998, at 16:

> "In tentatively concluding that BOCs should be able to continue providing intraLATA information services on an integrated basis, the Commission recognizes the higher costs of production associated with a decision to mandate structural separation. These costs are significant -- if not fatal in the current competitive environment -- to the introduction of new and innovative services .... structural separation would also require investment in duplicate facilities and increased administrative and overhead costs. Further, structural separation would create additional transaction costs arising from the decision to replace an integrated process that delivers retail consumer services with a corporate structure requiring that the production and sale of intermediate (or 'input') goods and services be subsequently altered or transformed before delivery to the retail market." (Emphasis supplied.)

The incumbents' view in Computer III and the separate affiliate theory reflected in the Advanced Wireline Services Order cannot each be correct. If separate data subsidiaries are truly as "lethal" to innovation as the incumbents claim, they can hardly be justified on the ground that they will stimulate innovation in advanced telecommunications services. On the other hand, if a separate subsidiary for advanced telecommunications is as innocuous as Ameritech claims, it can hardly be burdensome for information services in general.[11] The HAI Broadband Paper

[11] Of course, the policy tension created by contradictory positions concerning the efficiency aspects of separate subsidiaries also has a profound legal dimension, because the Computer III FNPRM is on remand from long-standing appeals in the Ninth Circuit, and because any attempt to forbear from applying section 251(c)(3) to a separate data affiliate will likely also be challenged. The Commission's tentative conclusions in Computer III FNPRM rest on the assumptions that: (1) integrated provisioning of advanced services fosters innovation; and (2) ISPs will not suffer

addressed the issue of efficiency and separate subsidiaries in depth, and concludes that: "... separate subsidiaries can provide benefits if properly constructed and enforced" (at 59).

The Computer III controversy also provides insight into the Commission's on-going difficulties in enforcing its own requirements. All the BOCs are perfectly entitled to provide intraLATA access to interLATA information services, and also to market those access services. However, it is manifestly clear that a BOC's permitted information access service turns into an interLATA information service -- and thereby requires, at a minimum, BOC provisioning via a section 272 subsidiary -- once a BOC: (1) bundles its charges for information access with the provisioning of an interLATA service (even where the interLATA portion is provided by a non-affiliated ISP); or (2) fails to provide end users a full choice of ISPs via its information access service; or (3) offers the service directly to end users rather than ISPs.[12]

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from integrated provisioning because section 251(c)(3)'s unbundling requirement will be fully applied. Obviously, the Commission will have to resolve the inconsistencies that exist between the minimal inefficiencies identified in the HAI Broadband Paper, and the incumbents' contrary claims in the Computer III FNPRM.

[12] Non-Accounting Safeguards Order, ¶ 57: " ... we conclude that the term 'interLATA information service' refers to an information service that incorporates as a necessary, bundled element an interLATA telecommunications transmission component provided to the customer for a single charge."" Among the incumbents, Bell Atlantic's advertisements claim that its services

(continued...)

Taking the case of Bell Atlantic, it is currently providing an information access service that triggers each of the above provisions without complying with section 272 or Computer III's comparative efficient interconnection ("CEI") rules. As ALTS pointed out in its June 16, 1997 opposition to BA's CEI Amendment (CCB Pol. 96-09), Bell Atlantic's "Internet Protocol Routing Service" or "IPRS" is: (1) bundled with interLATA information services charges; (2) fails to provide end users with a full choice of ISPS; and (3) is directed to end users rather than ISPs. Accordingly, Bell Atlantic's IPRS is currently being provisioned illegally by Bell Atlantic because it is not offered via a section 272 subsidiary, among other matters. The Commission's manifest difficulty in enforcing its current rules for information services provides ample demonstration that taking on additional responsibilities in this regard may not turn out as planned. The HAI Broadband Paper discusses enforcement issues in the context of CI II (at 67-69), and also concerning ONA and Computer III (44-45).

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[12](...continued)
(which include an interLATA function) are being provided by Bell Atlantic Internet Solutions Inc.

Nor is it a defense if Bell Atlantic could show it were only reselling an interLATA service. See Non-accounting Safeguards at 276: "We note that even when an information service and interLATA transmission service are ostensibly separately priced, if the BOC offers special discounts or incentives to customers that take both services, this would constitute sufficient evidence of bundling to render the information service an interLATA information service" (emphasis supplied).

II. MINIMUM POLICY REQUIREMENTS FOR IN-REGION AFFILIATES PROVIDING ADVANCED SERVICES.

Even if the laws of economics and of Title 47 did grant the Commission unfettered discretion in deregulating in-region affiliates (which they plainly do not), the Advanced Wireline Services Order's reliance on section 272 as interpreted in the Non-Accounting Safeguards Order is demonstrably unfounded and inadequate.[13] However, rather than simply oppose this initiative (though without waiving any of its legal rights), ALTS has chosen instead to discuss the specific requirements that should apply to such affiliates as a matter of sound pro-competitive policy.

As explained by the HAI Broadband Paper: "The theory of the separate subsidiary is that the monopoly parent will be forced to treat its competitive subsidiary the same as all other competitors. Indeed, the theory underlying the Commission's approach is that innovation in the underlying monopoly network will be stimulated by the requirement that the monopolist make service available to all across an arms-length bargaining relationship" (at 49). ALTS describes below the manner in which the Advanced Wireline Services NPRM's approach needs to be augmented, and details the additional minimum protections that would be necessary as a policy matter to insure an effective

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[13] Implementation of the Non-Accounting Safeguards of Sections 271 and 271 of the Communications Act of 1934, as Amended, Docket No. 96-149 (released December 24, 1996).

competitive market for advanced wireline services.

A. It Is Well Established that Separate Affiliates Requires Adequate Outside Ownership, and Vigorous Regulatory Supervision.

The threshold policy issue that must be confronted is an incumbent's interest in the economic success of its affiliate, and the economic failure of its competitors. The basic task is to prevent the incumbent from exercising its monopoly power to accomplish those goals via an in-region affiliate that enjoys lessened regulation.

1. In-Region Affiliates Should Have Appreciable Outside Ownership.

From ALTS' perspective, the best and simplest approach is to mitigate or eliminate the underlying economic motivation. Assume that an incumbent created an in-region data affiliate, and did not transfer assets, customers, or royalty rights to monopoly brand names, etc., to that entity. If it then spun off that affiliate completely, the former affiliate would look, act, and presumably be regulated, just like any start-up CLEC.[14]

On the other hand, the moment the incumbent starts retaining

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[14] The Advanced Wireline Services Order quotes Chuck McMinn, Chairman of the Board, Covad Communications Company, as endorsing the concept of a separate subsidiary (at n. 171). However, the Advanced Wireline Services NPRM makes no mention of the fact that COVAD's endorsement assumed substantial outside ownership of affiliates: "The ILEC could have some ownership interest in the separate entity, but would certainly not own a majority stock interest;" COVAD ex parte filed July 16, 1998.

any appreciable economic interest in the affiliate's success, there emerge incentives to evade the "tariff" interfaces the subsidiary promises to use. As the HAI Broadband Paper points out: "Separate subsidiaries do not change incentives" (at 46). Sadly, the Commission is not stepping up to an empty blackboard on this issue. It was these very incentives that drove the Department of Justice and the Bell System to agree to complete divestiture of the Bell System's local operating companies from its Long Lines division because of the inadequacy of regulatory remedies (United States v. Western Electric, 552 F. Supp. 133, 55 (D.D.C. 1981):

> "An even more formidable obstacle is presented by the question of enforcement. Two former chiefs of the FCC's Common Carrier Bureau, the agency charged with regulating AT&T, testified that the Commission is not and never has been capable of effective enforcement of the laws governing AT&T's behavior. In their view, this inability was due to structural, budgetary, and financial deficiencies within the FCC as well as to the difficulty in obtaining information from AT&T. Whatever the true cause, it seems clear that the problems of supervision by a relatively poorly-financed, poorly-staffed government agency over a gigantic corporation with almost unlimited resources in funds and gifted personnel are no more likely to be overcome in the future than they were in the past."

Given the inability of regulatory supervision to prevent evasion in the presence of appreciable economic incentives, the Department of Justice insisted on divestiture as the only sound cure (id. at 187):

> "It appears that the Department is the principal proponent of the restrictions on the Operating Companies. AT&T has

> generally taken the stance that it agreed to these restrictions as part of the overall settlement.
>
> "These restrictions are justified, according to the Department, because the Operating Companies will have 'both the ability and the incentive' to thwart competition in these markets by leveraging their monopoly power in the intraexchange telecommunications market. To permit the Operating Companies to compete in this market would be to undermine the very purpose of the proposed decree -- to create a truly competitive environment in the telecommunications industry. The key to interexchange competition is the full implementation of the decree's equal exchange access provisions .... If the Operating Companies were free to provide interexchange service in competition with the other carriers, they would have substantial incentives to subvert these equal access requirements. The complexity of the telecommunications network would make it possible for them to establish and maintain an access plan that would provide to their own interexchange service more favorable treatment than that granted to the other carriers. Such a result would perpetuate the very inequalities that the proposed decree is designed to eliminate. Finally, the Operating Companies would also have the ability to subsidize their interexchange prices with profits earned from their monopoly services."

Given the huge increases anticipated for data telecommunications compared to voice traffic, there is no question that incumbents would have the same incentives and ability to cheat on separate subsidiary rules remarkably similar to those that so alarmed DOJ and the MFJ court.[15]

While Judge Greene never ruled on the extent to which an economic interest constituted "affiliation" under the strictures of the MFJ, the Department of Justice proposed a five percent

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[15] "Bell Atlantic Launches Next-Generation Long Distance Data Network to Address $80 Billion Market for 21st Century Communications" (Bell Atlantic News release dated June 8, 1998).